

Reduce energy use by letting prices rise

By Clayne L. Pope, July 10, 2007

my view

As the mean world temperature slowly rises, the political heat for reduction of energy consumption is beginning to simmer. Governors and mayors are making gestures of leadership. With the recent rock extravaganza devoted to energy conservation, can political action be far behind?

To date, environmental advocates have relied on moral admonitions to reduce our carbon footprint — use fluorescent lights, drive hybrids, be organic — and politicians have trotted out the usual painless panaceas of new technologies and tax breaks to go green. But if the temperature continues to rise or even if it is perceived to be rising, the choice is going to come down to direct regulation of carbon use or to higher prices of oil and coal to compensate for their costs to the environment. The higher prices could be the result of a carbon tax or a market for CO₂ emission permits or some other device that would internalize the worldwide external cost from the use of fossil fuels.

Neither regulation nor higher energy prices are likely to be attractive to politicians, but experience suggests they will choose regulation given the powerful organized forces that favor regulation. This fundamental choice between the use of price and regulation to solve global warming could be the most important economic decision of coming decades.

The justice lobby will favor regulation. Price rationing invariably raises the issues of fairness and inequality. The poor will not only be choosing between food and prescription drugs, they will be choosing between food and heat in the winter or cool in the summer.

Those who make their living through a bigger and more powerful government will also favor direct regulation. Whatever else could be said about direct regulation, we can be sure that it increases the demand for regulators and for those who are paid to influence the regulators. The political sentiment against regulation will have to be strong to stave off the political class's natural tendencies.

Somewhat surprisingly, environmental activists also seem to be drawn to regulation rather than price change. Their ambivalence about price change comes from the moral dimension of the global warming movement. To the environmental moralists, no one should be allowed to drive that big SUV, even if they have to pay more to do it. No one should be allowed to indulge the taste for a long hot shower.

With a coalition of the fairness lobby, the bigger government lobby and the environmental moralists all favoring regulation and a growing perception that we must do something, direct control of our energy consumption seems to be in our future even though it would be a profound policy mistake. The market for energy feeds into all other markets. Mistakes in the energy market translate into mistakes everywhere. The price of energy may be even more important than the interest rate in decisionmaking.

Market-determined prices, including those with a tax or cap and trade intervention, have two very attractive features. First, prices deliver a higher level of efficiency in the economy because every household and business can key off of the same set of prices.

Second and most important, prices give us the freedom to make our own decisions subject to the proviso that we pay the price.

There will be constant moralizing about energy use. If we choose government regulation over higher prices, we will undoubtedly suffer from a less-efficient economy. But more significantly, we will give up some of our freedom. No one likes higher prices. But I would rather live free with higher energy prices than die from a thousand petty regulations and moral homilies.

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